INDEX.

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and other authorities involved	2
Statement	2
Specification of errors to be urged	5
Argument	6
Conclusion	8
Appendix	9–15

CITATIONS

Cases:	
Dibblee v. *Helvering*, No. 494, October Term, 1935	7
Helvering v. *Lee*, No. 111, October Term, 1935	7
McFeely v. *Helvering*, No. 24, October Term, 1935	8
Ogle v. *Helvering*, No. 137, October Term, 1935	7
Rand v. *Helvering*, No. 439, October Term, 1935	7
Statute:	
Revenue Act of 1928, c. 852, 45 Stat. 791, 811, 815, 818:	
Sec. 101	9
Sec. 111	11
Sec. 113	11
Miscellaneous:	
S. Rep. 960, 70th Cong., 1st Sess., p. 26	15
Treasury Regulations 74, Art. 596	13

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 110

UNITED STATES OF AMERICA, PETITIONER

v.

THE FIRST NATIONAL BANK OF BOSTON ET AL., Trustees

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court of the United States for the District of Massachusetts (R. 13–17) is reported in 7 F. Supp. 915. The opinion of the Circuit Court of Appeals (R. 21–25) is reported in 76 F. (2d) 200.

JURISDICTION

The judgment of the Circuit Court of Appeals reversing the judgment of the District Court was entered March 9, 1935 (R. 25). Petition for writ of certiorari was filed June 7, 1935, and was granted

October 14, 1935 (R. 25). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondents sold stock which they had received as residuary legatees of the decedent more than two years after the date of the death of the decedent but within two years of the date of the distribution of such stock to the respondents as residuary legatees. Was the stock "held" by the respondents for more than two years, so that the gain on the sale thereof is taxable as a "capital net gain" within the meaning of Section 101 of the Revenue Act of 1928?

STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved are set forth in the Appendix, *infra*, pp. 9–15.

STATEMENT

This is an action by the respondents as trustees under the will of the decedent to recover additional income tax assessed against them for the year 1928. The facts were stipulated (R. 4–6) and as found by the District Court (R. 11–12) may be summarized as follows:

Edward E. Blodgett of Newton, Massachusetts, died April 4, 1926 (R. 5), leaving a will (R. 5, 7) by the terms of which *inter alia* he devised the residue of his estate to the respondents in trust.

The decedent's will was duly probated, and the widow of the decedent qualified as executrix of the will. The respondents filed on March 15, 1929,[1] with the Collector of Internal Revenue at Boston, Massachusetts, income-tax returns as trustees with respect to the income of the trust estate for the calendar year 1928. The amount of the tax shown to be due was duly paid to the then Collector of Internal Revenue at Boston, Massachusetts, who, in turn, paid it over to the United States. (R. 5.)

Thereafter, on March 21, 1931, within the time allowed by law, the Commissioner of Internal Revenue assessed against the respondents an additional income tax for the year 1928 in the amount of $4,500.26 with interest of $544.47, which amounts, in the total sum of $5,044.73, were paid April 3, 1931, to the then Collector of Internal Revenue, who duly covered them into the Treasury of the United States. (R. 5.)

Part of such additional assessment was based upon the following action of the Commissioner of Internal Revenue (R. 5–6):

> The transfer by the Commissioner from capital net gain to ordinary income of the sum of $74,773.08. This sum represented the profit realized by the petitioners [the respondents] from the sale in 1928 of certain securities belonging to the trust estate. These securities had all been the property

[1] The stipulation (Par. 3) sets this date as 1928, but this is an obvious error.

of the decedent and a part of his estate at the time of his death, which was more than two years before the date of sale, but they had been received by the petitioners from the executors as a part of the petitioners' share as residuary legatees within two years from the date of sale. The basis used in determining the amount of the profit, both by the petitioners and by the Commissioner, was the fair market value of such property on the date it was transferred by the executors to the petitioners, in accordance with Section 113 (a) (5) of the Revenue Act of 1928.

After due claim for refund had been filed by the respondents with the Collector of Internal Revenue on July 29, 1931, and rejected by the Commissioner of Internal Revenue on January 22, 1932 (R. 6), the respondents instituted these proceedings in the District Court for recovery of the full amount of the additional assessment.

The District Court sustained the action of the Commissioner in transferring from capital net gain to ordinary income the sum of $74,773.08, which represented the profit realized by the respondents from the sale in 1928 of certain securities belonging to the trust estate. Judgment on that point for the United States was accordingly entered by the District Court (R. 11–12). The only question presented to the Circuit Court of Appeals was whether the item of $74,773.08 should be taxed

as capital net gain or as ordinary income. That court reversed the District Court, holding that the respondents were to be considered as having held the securities in question from the date of the death of the decedent, and that such date being more than two years prior to the respondents' sale of the securities, the securities were in their hands "capital assets" and the gain "capital net gain."

SPECIFICATION OF ERRORS TO BE URGED

The United States urges that the Circuit Court of Appeals erred:

1. In holding that the respondents, as residuary legatees receiving personal property upon distribution of the decedent's estate, were to be deemed to have held such property from the date of the decedent's death for the purpose of determining the holding period, under the provisions of Section 101 (c) (8) of the Revenue Act of 1928, *infra*.

2. In failing and refusing to hold that for the purpose of determining the holding period, under the provisions of Section 101 (c) (8) of the Revenue Act of 1928, *infra*, the respondents, as residuary legatees, should be deemed to have held personal property received upon distribution of the decedent's estate only from the date of actual distribution to the respondents.

3. In reversing the judgment of the District Court and remanding the case.

ARGUMENT

Section 101 (c) (8) of the Revenue Act of 1928, *infra*, provides that at the election of the taxpayer the tax on net gains from the sale of capital assets may be taxed at 12½ percent (instead of at the ordinary normal and surtax rates) and defines the term "capital assets" as "property *held by the taxpayer* for more than two years." (Italics supplied.) It is further provided that in determining the period for which the taxpayer has held property there shall be included the period for which the property was held by any other person if under Section 113 the basis for determining gain or loss on a sale of the property in the hands of the taxpayer is the same as it would have been in the hands of such other person. (Subdivision (c) (8) (B), *infra*.) Section 113 (a) of the Revenue Act of 1928, *infra*, so far as material here, provides that the basis for determining gain or loss on a sale of property *acquired* after February 28, 1913, shall be the cost thereof, with certain exceptions. Subdivision (a) (2) provides generally that if the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor. Under subdivisions (a) (5) the basis prescribed for real property acquired by general or specific devise or intestacy, and of personal property acquired by an estate from the decedent, is the value thereof at the date of decedent's death. In all

other cases of property acquired either by will or intestacy, however, which include general or residuary bequests, the basis specified is the value of the property *at the time of the distribution to the taxpayer.*

The securities here in question, from the sale of which the respondents realized a profit of $74,773.08, were distributed to the respondents as residuary legatees and were sold by the respondents less than two years after the date of distribution to them but more than two years after the decedent's death.

This case presents essentially the same question involved in *Helvering* v. *Lee,* No. 111, October Term, 1935; *Ogle* v. *Helvering,* No. 137, October Term, 1935; *Dibblee* v. *Helvering,* No. 494, October Term, 1935; and *Rand* v. *Helvering,* No. 439, October Term, 1935, now pending before this Court. In *Ogle* v. *Helvering, supra,* and *Rand* v. *Helvering, supra,* the taxpayers took under intestacy laws, whereas in the instant case and *Helvering* v. *Lee, supra,* the taxpayers were residuary legatees, and in *Dibblee* v. *Helvering, supra,* the taxpayer was a general legatee, but the question presented in all five cases is whether personal property of a decedent passing otherwise than by specific bequest may be considered to have been held by the recipient during any period prior to actual distribution for the purpose of satisfying the more than two-year requirement of Section 101 (c) (8) of the Revenue Act of 1928, *infra.*

McFeely v. *Helvering*, No. 24, October Term, 1935, pending before this Court, presents essentially the same question, although the facts are different, in that the taxpayer there was the donee of a widow who had elected under the laws of Pennsylvania to take against the will of her deceased husband. In the interest of brevity the petitioner adopts and incorporates herein by reference the argument presented in the brief filed on behalf of the respondent in *McFeely* v. *Helvering, supra*.

CONCLUSION

We respectfully submit that the decision of the court below was erroneous and should be reversed.

Respectfully submitted

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OCTOBER, 1935.

APPENDIX

REVENUE ACT OF 1928, C. 852, 45 STAT. 791, 811, 815, 818

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

* * * * *

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112 (g) of this title or under the provisions of section 203 (c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property ac-

quired after February 28, 1913, shall be the cost of such property;

* * * * *

(2) Gift after December 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) Transfer in Trust after December 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

* * * * *

(5) Property Transmitted at Death.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the

death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death; * * *.

TREASURY REGULATIONS 74

ART. 596. *Property transmitted at death.*—In the following cases the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the fair market value of the property at the time of the death of the decedent:

(1) Personal property acquired by specific bequest;

(2) Real property acquired by general or specific devise or by intestacy; and

(3) Property, whether real or personal, in the hands of a decedent's estate, acquired by the estate from the decedent (see article 863).

In all other cases where property was acquired either by will or by intestacy after February 28,

1913, the basis shall be the fair market value of the property at the time of its distribution to the taxpayer.

In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. Accordingly, if a person is entitled to personal property under such a trust instrument after the grantor's death and if such property would be deemed to be acquired by bequest, other than by specific bequest, were the trust instrument a will, the basis of the property, if acquired after February 28, 1913, would be its fair market value at the time it was distributed to the taxpayer. In all other cases where a person is entitled to property, whether real or personal, under such a trust instrument after the grantor's death, the basis of the property, if acquired after February 28, 1913, shall be its fair market value at the time of the grantor's death.

If the property was acquired prior to March 1, 1913, the gain or loss from the sale or other disposition thereof shall be computed upon the basis provided in section 113 (b) and article 591.

For the purposes of this article, the value of property as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes shall be

deemed to be its fair market value at the time of the death of the decedent.

S. REP. 960, 70TH CONG., 1ST SESS. (P. 26)

Accordingly, the committee has revised section 113 (a) (5) and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1885.

No. 110.

THE UNITED STATES OF AMERICA,
Petitioner,

v.

THE FIRST NATIONAL BANK OF BOSTON ET AL.,
Trustees Under the Will of Edward E. Blodgett,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR RESPONDENTS.

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TABLE OF CONTENTS.

	Page
Opinion Below	1
Jurisdiction	1
Statement of the Case	2
Status Involved	3
Summary of Taxpayers' Argument	6
Argument	9
As to Some of the Arguments in the Government's Brief	20
Conclusion	23
Appendix	25

TABLE OF CASES CITED.

Brewster v. Gage, 280 U. S. 327	3, 6, 9, 13, 19, 20, 21, 22
Crooks v. Harrelson, 282 U. S. 55	18
Davis v. Newton, 6 Met. 537 at 541	11
Helvering v. Bliss, 293 U. S. 144	6, 8, 14, 23
Helvering v. New York Trust Company, 292 U. S. 455	7, 8, 17, 19, 20
I. T. 1719 issued October, 1923 (C. B. II-2, 45)	12
I. T. 1889 issued January 1924 (C. B. III-1, 70)	12, 13
Lathrop v. Merrill, 207 Mass. 6, 10	11
Letter of Commissioner to Prentice Hall, Inc. of December 7, 1923 (P. H. Tax Serv. 1923, pp. 2703-4)	12
Old Colony Railroad v. Commissioner, 284 U. S. 542, at 560,	19
Revenue Act of 1918:	
Section 202	9
Revenue Act of 1921:	
Section 202	10
Section 206	12, 14
Revenue Act of 1928:	
Section 101	2, 3, 18, 19
Section 113	2, 5, 6, 15, 21
Section 115	17
Section 168	14
United States v. Merriam, 263 U. S. 179, 187-8	18

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM. 1935.

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BRIEF FOR RESPONDENTS.

OPINION BELOW.

The opinion of the District Court (R. 13–17) is reported in 7 Fed. Supp. 915, and the opinion of the Circuit Court of Appeals (R. 21–25) in 76 Fed. (2) 200.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 9, 1935 (R. 25). The petition for writ of certiorari was filed June 7, 1935, and granted October 14, 1935.

STATEMENT OF THE CASE.

The Respondents (hereinafter for convenience usually called the taxpayers) are residuary legatees under the will of Edward E. Blodgett, late of Massachusetts, who died April 4, 1926. As such residuary legatees, they received, before April 4, 1928, as a part of their share of the estate, certain securities, all of which had been the property of the decedent and a part of his estate at the time of his death. These securities were sold by them between April 4 and December 31, 1928,—more than two years after the decedent's death, but less than two years after the date when they were distributed to them by the Executors.

The controversy arises over the action of the Commissioner of Internal Revenue in transferring from capital net gain to ordinary income subject to normal and surtaxes the sum of $74,773.08. This sum represented the amount of the gain realized by the Trustees from the sale of the securities referred to above. The amount of the gain was computed in accordance with the provisions of §113 (a) (5) of the Revenue Act of 1928, and there is no question as to the correctness of that computation.

The only question involved here is whether these securities came within the definition of "capital assets" under §101 (c) (8) of the Revenue Act of 1928 as "property held by the taxpayer for more than two years".

The taxpayers contend that, since personal property of a decedent which is received by a residuary legatee

is acquired by such legatee at the date of the decedent's death (*Brewster* v. *Gage*, 280 U. S. 327), it follows that the property was held by the taxpayers for more than two years.

The Government contends that, since Congress in another section of the Revenue Act of 1928 changed the residuary legatee's base date for the purpose of computing the amount of his gain or loss on the sale of such property from the time of his acquisition of such property to the time of the distribution of such property to him by the executors (§113 (a) (5)), such property was not held by the taxpayers for more than two years within the meaning of §101(c) (8) of that Act.

STATUTES INVOLVED.

Revenue Act of 1928.

"SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in Case of Capital Net Gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain. . . .

(c) *Definitions.*—For the purposes of this title—

(1) 'Capital gain' means taxable gain from the sale of exchange of capital assets consummated after December 31, 1921. . . .